Supreme Court, U.S.
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JOSEPH F. SPANIOL, JR.
CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1988

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No. _____

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JOE WATTS MARTIN, SR. AND
ROSE PUGH MARTIN, Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

PETITION FOR A WRIT OF CERTIORARI TO THE
UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

---

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August 19, 1988

## QUESTION PRESENTED

1. Whether the imposition of the 50% fraud penalty by the Commissioner of Internal Revenue under the provisions of §6653(b) of the Internal Revenue Code in a civil income tax case using the same facts and figures that were used in a criminal trial on income tax fraud charges wherein the taxpayer was acquitted, constitutes denial of due process and equal protection under the law, double jeopardy, a violation of his civil rights, and renders the statute unconstitutionally vague.

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# PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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Petitioners Joe Watts Martin and wife Rose Pugh Martin respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court Of Appeals For the Fifth Circuit entered in

this proceeding on May 24, 1988.

## OPINION BELOW

The opinion of the Court Of Appeals appears in the Appendix hereto.

## JURISDICTION

The judgment of the Court Of Appeals For The Fifth Circuit was entered on May 24, 1988. This petition for certiorari was filed within 90 days of that date. This Court's jurisdiction is invoked under 28 USC 2101(c).

## QUESTION PRESENTED

1. Whether the imposition of the 50% fraud penalty by the Commissioner Of Internal Revenue under the provisions of §6653(b) of the Internal Revenue Code in a civil income tax case using the same facts and figures that were used in a criminal trial on income tax fraud charges wherein the taxpayer was acquitted, constitutes denial of due process and equal protection under the law, double jeopardy, a violation of his civil rights, and renders the statute unconstitutionally vague.

## STATUTORY PROVISIONS INVOLVED

United States Code:

§6653(b) Internal Revenue Code:

(b) FRAUD.-If any part of any underpayment (as defined in subsection (c))of tax required to be shown on a return is due to fraud, there shall be added to the tax an amount equal to 50 percent of the underpayment.

## STATEMENT OF THE CASE

Joe Watts Martin Sr. and his wife Rose Pugh Martin opened a small florist shop on the Mississippi Gulf Coast in 1945 with $1,000.00 capital at Pascagoula, Mississippi. This was a small family business that the Martins operated for the next 25 years, during which time they raised 7 children. Most of the family members worked in the business, which experienced little growth during the 25 year period from 1945 to 1969. At that point the net worth of the business and of the Martins

combined amounted to less than $100,000 in total.

Joe Watts Martin Sr. had about a 11th grade education and had held various factory jobs before entering the florist business. Rose Martin had been a schoolteacher. Neither had any prior business training or experience or knowledge of accounting or income tax rules.

In the year 1970 Litton Industries opened the West Bank shipyard, bring their employment to 25,000 employees. Prior to that Pascagoula had scarcely had a total population of that amount. This new business activity created a "boom" in business for many of the businesses that were located in Pascagoula, including the florist shop operated by the taxpayers. Their business increased ten-fold overnight in volume.

Joe Martin continued to handle the business part of the operation, including making up bank deposits, buying merchandise for resale, banking, paying bills, supervising employees, and all the while working as a floral designer.

Mrs. Martin, in addition to taking care of her 7 children, also worked in the business as a floral designer and in posting and keeping up their voluminous "A to Z" accounts receivable ticket files showing what charge customers owed the business. She did not otherwise participate in handling the business end of the shop. Joe Martin gathered the information for use in preparing the income tax returns and turned it over in worksheet-form to a public accountant, who prepared partnership income tax returns for the shop and individual returns for the taxpayers. They had operated as a husband-wife partnership business since the shop opened.

The taxpayers suffered poor health for years, and particularly during the six years that are the subject of this case, 1970-1975. Mrs. Martin has crippling arthritis which has progressively worsened over the years, and Joe Martin has had several hernia operations, lost an eye to glaucoma, had back problems,

and various other ailments. However, in spite of their health problems, the taxpayers continued to run the florist shop over the years.

The average sale in the florist shop was about $9.00, and thousands of tickets were handled each month. The majority of the sales were charge tickets, which had to be posted to the A to Z index. The paperwork got out of hand. On two occasions, they hired additional office help, but neither employee proved to be the needed help, and Mrs. Martin continued to work on the A to Z index, while Joe Martin continued to be in charge of the rest of the shop's business.

Many of their expenses and purchases were paid by check, but some local shop expenses were routinely paid out of petty cash, and the payroll was always paid in cash. On occasion, shipments of flowers coming in by bus were also paid by cash because the bus station would not accept checks. As to sales,

many customers paid by check, a fair number by cash, some by credit cards, and a substantial amount by or through FTD (Federated Teleflorist Delivery).

The FTD transactions were voluminous, making up about half of their sales. This meant that there was a steady stream of funds flowing through the shop representing a liability to other florists for about 80% of the local incoming FTD orders. Credit was given to them for incoming FTD orders, and the difference was remitted to FTD for disbursement to the various florists in other locations who filled the orders.

Since its inception the shop had never maintained a formal set of books in the form of journals, general ledgers, etc., but over the years most if not all of the shop's records consisting of band statements, invoices, expense tickets, payroll records, sales tickets, FTD records, etc., were kept, syste-

matically arranged, and stored in boxes, in the shop or in a shed adjoining the shop.

It was from these various records that Joe Martin would compile the information for preparing income tax returns. During the "boom" years, he admitted that he started to estimate some of the figures, particularly sales and some of the cost of sales figures.

Martin started making deposits in savings accounts during the six years under review. This was done from time to time, and at the end of the six years the savings had increased by over $212,000, including the interest that had accumulated. All of the interest income was properly reported on the income tax returns. These accumulated savings represented the majority of the understatements of income determined by the IRS for the period, and practically all of the savings funds were on hand at the end of the period.

Both of the Martins were in their sixties during the six-year period under review.

The IRS agent described their lifestyle as moderate, and they were known to have worked long hours in the florist business over the years.

The Martins had filed all income tax returns on a timely basis throughout the years, and had done likewise as to their employment tax returns.

Living on the Gulf Coast, Joe Martin bought a boat for his family's use, and later sold it and bought a larger one, but as it turned out, the boats were seldom used. Nor were they yacht-class-type boats, but ranged in price from $10,000 to $22,000. The Martins also made small gifts to their children during the years under review, some of whom were in college.

During the year 1976, on a random-selection basis, the Miss. State Tax Commission made a sales tax audit on the florist shop. This was the first tax audit of any kind that the Martins had encountered.

The Sales tax agent asked for and used for the most part the bank statements and some of the FTD records in conducting his audit. He presented the shop with a report showing that it owed about $25,000 in additional sales tax for the previous three-year period. He also recommended and suggested to Martin that he should consider amending his income tax returns. Martin promptly paid the sales tax assessment and turned the sales tax audit report over to his public accountant, who proceeded to use the figures on the report to prepare amended income tax returns for three years. Some of the cost of sales figures were furnished to her by Martin. The federal and state taxing authorities have reciprocal agreements to furnish audit data to each other, and the Miss. State Tax Commission furnished the IRS with its report on the sales tax audit.

An agent from the IRS was assigned the returns for audit. He determined that taxable income had been substantially under-reported,

and decided that the amounts of unreported taxable income were approximately the same amount of payroll. It appeared that the cash used to pay payroll apparently was not added to sales, making up most of the difference. He basically completed his audit examination, but IRS policy dictates that large deficiencies be reported to the Criminal Investigation Division Of IRS to see if it is possible to make out a criminal fraud case from the findings, and this was done by the IRS agent, who stated that he expected to receive the case back for routine closing out, based on the age and health of the taxpayers, their cooperation with him, and on the apparent nature of the deficiencies. He was "shocked" to learn that the Service had accepted the case as a criminal fraud case, and was instruced to make an additional visit to the shop along with an IRS Special Agent from the CID for the purpose of beginning the criminal fraud case.

After months of investigation, a dozen or more interviews with Joe Martin, and preparing detailed records based for the most part on documents he had furnished them, the IRS came out with a criminal case based on income tax deficiencies for each of the six years, using the net worth approach to work up their numbers. Their findings were:

| | Unreported Taxable Income | Addnl Income Tax | 50% Fraud Penalty |
|---|---|---|---|
| 1970 | $49,232 | $ 12,413 | $ 6,206 |
| 1971 | 31,525 | 10,186 | 5,093 |
| 1972 | 76,376 | 32,563 | 16,282 |
| 1973 | 31,257 | 11,847 | 5,924 |
| 1974 | 59,099 | 27,535 | 13,768 |
| 1975 | 80,620 | 44,159 | 22,080 |

In addition, interest charges of approximately $260,000 have been billed to the taxpayers.

Joe Martin was not represented by counsel or otherwise until he was notified by the CID of IRS that his case would be sent to the Justice Department for prosecution as a criminal tax fraud case.

A federal grand jury in Jackson, Miss. issued an indictment against Joe Martin for each of the six years 1970-1975 on the basis of income tax fraud.

A district court trial was held, and when the government rested its case, the federal district court granted Martin a directed verdict of acquital on all counts for all years, stating that the government had failed to show that Martin had commited any affirmative acts to support the government's contention that the under-reporting was willful and intentional.

Rose Martin was never questioned, indicted or tried throughout the entire process.

The IRS then proceeded to bill the taxpayers for the additional income taxes, the 50% fraud penalty under §6653(b) of the IRC, and later sent a notice of deficiency. The Martins filed their petition in the U.S. Tax Court, contesting all deficiencies, penalties and interest.

If the Tax Court were to find no fraud involved, then all statutes of limitations would have expired, and the Martins would owe nothing. However, if fraud was found, then none of the statutes of limitation would have been deemed to have closed, and they would owe all taxes, penalties and interest. Other side collateral issues were involved, i.e, whether in the absence of fraud, would the six-year statute of limitations have run, and in any event, whether Rose Martin was an "innocent spouse" within the meaning of the IRC, but these issues are not raised here.

The sole issue presented is whether it is lawful for the U.S. Tax Court to find a taxpayer guilty of tax fraud based on the same facts and numbers presented in a previous criminal tax fraud trial in which the taxpayer was acquited.

## REASONS FOR GRANTING THE WRIT

The lead case on this subject is Helvering v Mitchell, 303 US 391 (1938), which holds that neither acquittal nor conviction of a taxpayer in a prosecution involving criminal penalties can bar the assessment and collection of the 50% fraud penalty. It holds that the burden of proof in criminal and civil cases is different and precludes application of the doctrine of res judicata, and that res judicada is precluded also by the difference in the issues presented in the two cases; that although the indictment and this (civil) proceeding arise out of the same transactions and facts, the issues in them are not the same; that on the indictment the issue was whether the taxpayer had "willfully" attempted to "evade or defeat" the tax; that whether he had done so "fraudulently" was not there an issue, and that in this proceeding the issue is speci-

fically whether the deficiency was "due to fraud." The case further explains that Congress provided a distinctly civil procedure for the collection of the additional 50%, thus indicating clearly that it intended a civil, and not a criminal, sanction, and that civil procedure is imcompatible with the accepted rules and constitutional guaranties governing the trial of criminal prosecutions, and that where civil procedure is prescribed for the enforcement of remedial sanctions, those rules and guaranties do not apply.

An attempt to make the distinction clearer is offered is given with the explanation that the sanction of fine and imprisonment prescribed by the criminal statute for "wilfull attempts "in any manner to evade or defeat any income tax" is obviously a criminal one, while the sanction of 50% addition "if any part of any deficiency is due to fraud with intent to evade tax" was clearly intended as a civil one.

It is well accepted in tax cases that it is the state of mind of the taxpayer that determines his intent as to matters arising about his taxes. It can be further summarized by looking to the issue of "willfulness", which of course is a condition of state of mind.

The following analogy is useful in examining this:

> "Civil penalties are imposed where there is 'fraud with intent to evade tax.' What constitutes 'fraud with intent to evade tax' so as to invoke application of the civil penalties is discussed at ¶5533.19. Fraud which incurs a civil penalty is not necessarily 'willful' so as to incur a criminal penalty; on the other hand, fraud which is 'willful' so as to incur criminal penalties necessarily requires 'intent' and invokes also the civil penalties."
>
> -CCH Explanation
> Vol. 9 CCH-Standard
> Federal Tax Reports
> Page 65,515
> ¶5709.014

This concept is fortified in Lefkowitz v. Tomlison, 334 F. 2d 262 (1964), Cert. denied, which holds that a taxpayer convicted of fraud

in a criminal tax fraud case is estopped from escaping the 50% civil fraud penalty because he has been convicted on the criminal charge.

Granted that Congress intended both a civil penalty and a criminal penalty. Granted that the givernment should have the right to bring criminal charges in a tax fraud case, and to seek the tax and civil penalties if the taxpayer is convicted on the criminal charge, which bars the statute of limitations.

But what about the case where there is an acquital in the criminal case on the same facts and transactions as will be brought up in a civil case? The present results are:

(a) If you are convicted on the criminal, you are estopped from denying civil fraud, because you have been found guilty of civil fraud.

(b) If you are acquitted on the criminal charges, it doesn't mean a thing in considering civil fraud.

The fact is that fraud is fraud, whether considered in a civil matter or in a criminal case. The next consideration in both is wilfullness and intent, and the thing that turns the cases are the affirmative acts of the taxpayer which tend to prove or disprove the wilfullness and "state of mind" question.

Notwithstanding all of the reasoning set forth in Helvering v Mitchell, supra, about the fine distinctions, it becomes quite clear from reading all of the tax fraud cases, both civil and criminal, that the attempted distinctions amount to nothing more than a play on words. The cases reveal that where tax fraud is an issue, the same points are looked for and considered every time.

Likewise, the U. S. Courts Of Appeals and the U. S. Tax Court use identical criteria in reviewing the cases.

The best proof of this is the point alluded to above which states that a taxpayer

convicted on criminal tax fraud charges is estopped from defending against the civil fraud penalty.

This brings it to the point that if you are guilty of criminal tax fraud, you are automatically guilty of civil tax fraud, but if you are found not guilty of criminal tax fraud, you can still be held for civil tax fraud, on the same facts and circumstances and using the same elements of fraud in considering both.

Once again we see a "double standard" unfold....one that any citizen accused of tax fraud by the IRS will find himself helpless to deal with.

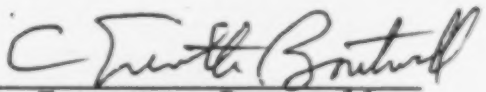
The seemingly endless power of the IRS is by this type of thing substantially enhanced, to the point that it can say with confidence, and be correct in so stating, that "we're not worried about these type cases....we will see you now, or see you later." And they surely do.

The end results is that a taxpayer taken to task by the government and who is successful in being acquitted of criminal tax fraud charges will be subjected to denial of due process and equal protection under the law, double jeopardy, res judicata, a violation of his civil rights, and probabilities of being unlawfully denied of his property, all because the cases interpreting the civil and the criminal statutes are repugnant and any intended distinctions between the civil and the criminal as to how it all really works, are so overlapping and mixed up so as to render the statutes themselves unconstitutionally vague, and as such they should be stricken and declared to be unconstitutional, or in the alternative at least in some manner they should be sorted out, "shored up" and made to be consistent and to serve their intended purposes.

## CONCLUSION

For these reasons, a writ of certiorari should issue to review the judgment and opinion of the Fifth Circuit.

Respectfully submitted,



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Counsel For Petitioners

Rule 28.1 Disclosure

Parent companies, subsidaries, and Affiliates Of the Petitioners: NONE

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1988

---

No._____

---

JOE WATTS MARTIN, SR. AND
ROSE PUGH MARTIN, Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

---

CERTIFICATE OF SERVICE

I Hereby certify that on this the 22nd day of August, 1988, three (3) copies of the Petition For Writ Of Certiorari were mailed, postage prepaid, to William S. Rose, Jr., Asst. Attorney General, Tax Division, U. S.

Department Of Justice, P O Box 502,

Washington, DC 20044.

I further certify that all parties required to be served have been served.

Dated: August 22, 1988

C. Everette Boutwell

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# APPENDIX

Opinion

Judgment Of Court

Of Appeals

IN THE UNITED STATES COURT OF APPEALS

FOR THE FIFTH CIRCUIT

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No. 87-4600

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JOE WATTS MARTIN and
ROSE PUGH MARTIN,
Petitioners-Appellants

versus

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee

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Appeal from the Decision of the
United States Tax Court

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Before WISDOM, GEE and JONES,
Circuit Judges.

PER CURIAM:*

The judgment is affirmed for the reasons stated by the Tax Court in its opinion of March 30, 1987.

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*Local Rule 47.5 provides: "The publication of opinions that have no precedential value and merely decide particular cases on the basis of well-settled principles of law imposes needless expense on the public and burdens on the legal profession.: Pursuant to that Rule, the Court has determined that this opinion should not be published.

T.C. Memo. 1987-170

UNITED STATES TAX COURT

JOE WATTS MARTIN AND ROSE PUGH MARTIN,
Petitioners

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 16242-81 Filed March 30, 1987

C. Everette Boutwell, for the petitioners.

Robert W. West, for the respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

SCOTT, Judge: Respondent determined deficiencies in petitioners' income tax and additions to tax under section 6653(b)[1] for the years and in the amounts as follows:

| Year Ended Dec. 31 | Income Tax | Addition to Tax Sec. 6653(b) |
|---|---|---|
| 1970 | $12,412.90 | $ 6,206.45 |
| 1971 | 10,185.63 | 5,092.82 |
| 1972 | 32,563.46 | 16,281.73 |
| 1973 | 11,847.12 | 5,923.56 |
| 1974 | 27,535.15 | 13,767.58 |
| 1975 | 44,159.34 | 22,079.67 |

At the conclusion of the trial respondent conceded that he had not shown fraud on the part of Mrs. Martin and on brief petitioners conceded that respondent's net worth determination with an agreed adjustment for additional state sales

1 All references are to the Internal Revenue Code 1954, as amended unless otherwise indicated.

tax correctly reflects petitioners' taxable income for the years here involved. These concessions leave for our decision (1)whether assessment of additional tax for each of the years here in issue is barred by the statute of limitations, (2) whether any part of the underpayment of tax for each of the years here in issue is due to fraud with intent to evade tax on the part of Joe Watts Martin under section 6653(b), (3) if it is held that the returns for the years 1974 and 1975 were not fraudulent so as to remove the bar of the statute of limitations provided for by section 6501 (a), was there an omission of more that 25 percent of gross income for each of the years 1974 and 1975 within the meaning of section 6501(e), and (4) whether petitioner Rose Pugh Martin is entitled to be relieved from the deficiencies in tax in each of the years here in issue as an innocent spouse under the provisions of section 6013(e)(1).

## FINDINGS OF FACT

Petitioners, husband and wife, who resided in Pascagoula, Mississippi, at the time the petition in this case was filed, filed joint Federal income tax returns for each of the calendar years 1970, 1971, 1972, 1973, 1974, and 1975. Petitioners filed amended Federal income tax returns for the calendar years 1973, 1974, and 1975.

During the taxable years here involved, petitioners operated a business under the name of Pugh's Floral Shop as equal partners. Petitioners began their floral business as a partnership in 1945 with $1,000 which Mrs. Martin had received as a gift from her parents.

In 1969 the Engles Shipbuilding Yard reopened in Pascagoula, Mississippi, and began employing approximately 20,000

people. The increase in population of Pascagoula and the increase in jobs available because of the opening of the Engles Shipbuilding Yard coincided with an increase in petitioners' sales in their florist business.

Petitioner Joe Watts Martin left high school in the eleventh grade and entered the Merchant Marines. Thereafter he worked at several different types of jobs until he and his wife opened the floral business in 1945. Mrs. Martin was a college graduate and after her marriage to Mr. Martin in 1934 taught Latin in high school for a number of years. When the floral business opened, and continuing thereafter, she worked actively in the business. Petitioners had seven children, the oldest born in 1935 and the youngest in 1953.

Mr. Martin did most of the record keeping of the florist shop, but Mrs. Martin worked on the files involving charge sales, posting the account when payment was made. These files were referred to by petitioners as the A to Z files. Petitioners did not keep a formal set of books for their floral business. The records they maintained included their bank statements, cancelled checks, deposit slips, some payroll records, some receipts for bills paid, and boxes of sales tickets. Charge tickets reflecting accounts receivable were arranged alphabetically in an index file (the A to Z files). Petitioners' records also included statements received with respect to Florist Trans-World Delivery (FTD) sales.

During the years here in issue, both petitioners had some medical problems. Mr. Martin had several hernia operations and also a problem with his eyes, and Mrs. Martin suffered from arthritis. During the years here in issue petitioners had no bookkeepers assisting them in their floral business, although in prior years they did on at least two occasions temporarily employ a bookkeeper. Three of petitioners' sons worked in the business during the years here in issue. Petitioners' sons would at times make out sales tickets and at times assist Mrs. Martin with the A to Z files, as well as sell flowers. Mr. and Mrs. Martin did most of the floral design. In addition to their three sons, petitioners at times had part-time help with the selling and school boys on a part-time basis

for delivery boys.

Mr. Martin at the end of each year would enter figures on sheets of paper and take these figures to the return preparer who had prepared their returns for a number of years prior to the years here in issue. The return preparer would enter the figures furnished her by Mr. Martin on the Forms 1065, Partnership Returns of Income, and on petitioners' Federal income tax returns filed in each of these years. The original 1065 Forms filed by petitioners for their partnership business which were prepaared by the return preparer from figures furnished to her by Mr. Martin show the following for the years indicated:

| | 1970 | 1971 |
|---|---|---|
| Gross Receipts: | $54,431.09 | $64,686.70 |
| Less: Cost of Goods Sold: | 19,532.98 | 22,317.25 |
| Gross Profits: | 34,898.11 | 42,369.45 |
| Total Deductions: | 28,467.90 | 30,695.75 |
| Ordinary Income: | 6,430.21 | 11,673.70 |

| | 1972 | 1973 |
|---|---|---|
| Gross Receipts: | $75,160.11 | $95,161.47 |
| Less: Cost of Goods Sold: | 24,669.77 | 34,273.43 |
| Gross Profit: | 50,490.34 | 60,888.04 |
| Total Deductions: | 38,470.28 | 52,958.21 |
| Ordinary Income: | 12,020.06 | 7,929.83 |

| | 1974 | 1975 |
|---|---|---|
| Gross Receipts: | $113,582.88 | $139,329.57 |
| Less: Cost of Goods Sold: | 38,479.35 | 47,818.22 |
| Gross Profit: | 75,103.53 | 91,511.35 |
| Total Deductions: | 67,630.07 | 77,868.81 |
| Ordinary Income: | 7,473.46 | 13,642.54 |

Included in the total deductions for the years here involved were $14,390.55 for salaries and wages for 1970, $13,260.00 for salaries and wages for 1971, $18,585.00 for salaries and wages for 1972,$30,838.38

for salaries and wages for 1973, $42,609.99 for salaries and wages for 1974, and $47,281.53 for salaries and wages for 1975. On each of the Forms 1065, the ordinary income is shown as equally divisable between Mr. & Mrs. Martin. On their joint income tax returns filed for each of the years here in issue, petitioners showed the following sources of income and adjusted gross income:

| | 1970 | 1971 |
|---|---|---|
| Interest Income: | $1,328.97 | $ 2,403.07 |
| Income Other Than Wages, Dividends & Interest: | 6,430.21 | 11,673.70 |
| Adjusted Gross Income: | 7,759.18 | 14,076.77 |

| | 1972 | 1973 |
|---|---|---|
| Interest Income: | $ 5,218.55 | $ 5,900.76 |
| Income Other Than Wages, Dividends, & Interest: | 12,020.06* | 7,929.83 |
| Adjusted Gross Income: | 17,238.61 | 13,830.59 |

* Incorrectly shown as wages, salaries,etc.

| | 1974 | 1975 |
|---|---|---|
| Interest Income: | $10,130.09 | $15,723.62 |
| Income Other Than Wages, Dividends, & Interest: | 7,473.46 | 13,642.54 |
| Adjusted Gross Income: | 17,603.55 | 29,366.16 |

Petitioners during the years here in issue had no income from any source other than their interest income and income from their floral business. The work sheets supplied by Mr. Martin to the return preparer did not contain all the information necessary to file proper returns for the partnership and petitoners for the years here in issue. The work sheets showed

gross receipts supplied by Mr. Martin to the return preparer were not prepared from any records of the business, but were estimated by Mr. Martin. Pugh's Floral Shop received payments for sales of goods and services in cash, by check, and by charge account, including charge cards. Petitioners did not deposit all of the receipts of Pugh's Floral Shop into bank accounts during the years here in issue. Some of the amounts not deposited were used for business expenses and some of the amounts were used for personal expense.

During 1976, the Mississippi State Tax Commission performed a sales tax audit of petitioners' floral shop. The sales tax audit was for a portion of 1973 and all of 1974 and 1975. The audit resulted in additional sales tax being

paid by petitioners to the State of Mississippi for 1973 of $4,043.23, for 1974 of $6,529.84, and for 1975 of $7,144.54. In conducting the sales tax audit, the state examiner determined gross sales from total bank deposits using bank statements and deposit slips and from FTD statements. After his audit, the Mississippi state examiner suggested to Mr. Martin that he file amended partnership returns and income tax returns for the years 1973, 1974, and 1975. Petitioner filed amended partnership returns for each of these years reporting the following:

| | 1973 | 1974 |
|---|---|---|
| Gross Receipts: | $231,129.64 | $256,388.95 |
| Less Cost of Goods Sold: | 159,317.32 | 167,270.47 |
| Gross Profit: | 71,812.32 | 89,118.48 |
| Total Deductions: | 64,219.58 | 84,399.63 |
| Ordinary Income: | 7,592.74 | 4,718.85 |

| | 1975 |
|---|---|
| Gross Receipts: | $296,332.87 |
| Less Cost of Goods Sold: | 176,896.32 |
| Gross Profit: | 119,436.55 |
| Total Deductions: | 93,809.87 |
| Ordinary Income: | 25,626.68 |

The amounts for salaries and wages included in total deductions were the same as the amounts shown on the original parnership returns for each of the years 1973, 1974 and 1975.

The amended joint Federal income tax returns filed by petitioners for the years 1973 and 1974 showed a decrease in income of $337.09 and $2,754.61, respectively. The decreases were explained as resulting from errors in computing profit for the parntership returns. Petitioners' amended joint Federal income tax return for 1975 showed an increase in reported income of $11,984.14 with corrected 1975

income being shown as $41,350.30, with the explanation that the change resulted from an error in computing partnership income. The amended joint returns filed by petitioners were based on interest income as previously reported and the revised figures from the amended Forms 1065, Partnership Returns of Income. The gross receipts used in the amended partnership returns of income were the figures compiled by the state tax examiner.

The total deposits to petitioners' business bank accounts at the Pascagoula Moss Point Bank and the Merchants and Marine Bank were $161,641 for 1971, $192,460 for 1972, $232,994 for 1973, $256,633 for 1974, and $295,292 for 1975.

All of the salaries paid by petitioners to their employees during the years here in issue were paid in cash. Salaries were

paid to petitioners' three sons who worked in the business and the part-time persons who worked there. Also during the years here in issue, petitioners paid several specific suppliers in cash on a regular basis. Petitioners paid Baldwin Wholesale Florist approximately $15,000 per year in cash and paid Youngstown Wholesale Florist approximately $5,000 a year in cash. Petitioners also paid cash for plants from some of their suppliers of plants. When a shipment of flowers arrived at the bus station, petitioners would always pay the shipping cost in cash since the bus station would not accept a check for payment. Petitioners also paid their life insurance premiums in cash and made donations to their church in cash. When petitioners received a business check which they thought might be questionable, they would

negotiate the check for cash and use the proceeds to pay personal or business expenses. These checks were not deposited in a business bank account. Petitioners had receipts for some of the cash payments made for merchandise and also had some payroll records, but they were not in such order as to enable anyone to ascertain if they were complete. During the years here in issue, in addition to paying certain expenses (personal and business) with cash that was never deposited in their checking accounts, petitioners also paid living expenses by check from the partnership checking acounts at the Pascagoula Moss Point Bank and the Merchants and Marine Bank. Petitioners identified some, but not all, of their personal checks by writing the letters "Prop" on the checks.

At various times during the years 1969 through 1975, petiioners maintained savings accounts at the Bankers Trust Savings and Loan Association, First Federal Savings and Loan Association, Pine Belt Savings and Loan Association, and Twin Cities Savings and Loan Association. Some of the savings accounts were in the joint names of petitioners and were held in joint ownership. Because of Mrs. Martin's arthritic condition, Mr. Martin handled most of the deposits, withdrawals, and renewals to the savings accounts. Mrs. Martin was aware of the savings accounts and signed the signature cards required by the savings and loan associations for the creation of the savings accounts. The following table shows the yearly increases in the savings accounts maintained by petitioners, including the amounts from reinvested interest:

| Year | Amount |
|---|---|
| 1970 | $ 23,027.80 |
| 1971 | 20,125.37 |
| 1972 | 58,032.38 |
| 1973 | 32,711.64 |
| 1974 | 34,679.52 |
| 1975 | 43,780.06 |
| | $212,356.77 |

Among the saving accounts petitioners maintained during the years here in issue were some certificates of deposit. When a certificate of deposit matured, Mr. Martin took the principal amount of the account, added the interest amount that had accrued and at times additional cash from the business to the account, and established a new or renewed certificate of deposit.

Petitioners received a summary report from FTD at the end of each month detailing

the incoming and outgoing FTD sales for the month.

The sales invoices retained by petitioners for the year 1975 totaled $407,462.22. Of that amount$284,369.71 showed payment by check (69.79 percent), $66,187.44 showed payment by cash (16.24 percent), and $56,919.27 showed payment by other methods, including credit card purchases and FTD purchases.

During the years here in issue, petitioners made a number of substantial gifts to their children. In 1971, petitioners purchased an automobile for one of their sons for $2,753.04, which was paid by check drawn on the business account. In 1972, petitioners paid $4,737.60 for real estate purchased by one of their sons, also by check drawn on the partnership account. In 1972, they purchased an automobile

for one of their daughters for $4,058.34. In 1974, petitioners paid a loan due for one of their sons in the amount of $1,563.58. In 1970, petitioners gave land with a cost basis of $10,000 to one of their sons.

During 1972, petitioners purchased a 25 foot Allmand boat for $11,434. This boat was registered in Mr. Martin's name. In 1974, petitioners purchased a 28 foot Allmand boat for $26,061.74. This boat was purchased by a series of cashier's checks drawn by Mr. Martin and payable to John Allmand Boat Inc. This boat was also registered in Mr. Martin's name.

The State of Mississippi tax auditor notified the Internal Revenue Service of the understatement of sales he had found when investigating the sales tax liability of Pugh's Floral Shop. After this notification,

the original and amended returns of petitioners for the years 1973, 1974, and 1975 were assigned to a revenue agent in Biloxi, Mississippi, for examination. This agent was shortly to leave his employment with Internal Revenue Service. He called on petitioners at their place of business and commenced the examination. He was of the opinion that the understatement might have been caused by petitioners' failure to include in sales the amounts of wages paid in cash by the florist parnterhsip. Because of the size of the understatement this agent found, he referred the case to the Criminal Investigation Division of the Internal Revenue Service, although he had not completed his examination.

A special agent of the Internal Revenue Service called upon Mr. Martin and after

telling Mr. Martin of the right he had to remain silent and that any answers he gave might be used against him, asked Mr. Martin a series of questions. This was the first of a number of interviews the special agent had with Mr. Martin. When respondent's special agent interviewed Mr. Martin, Mr. Martin told the agent that he had determined sales of the floral business from bank deposits. He also told him he did not pay any creditors regularly in cash and said that except for the state sales tax, he could think of no purchases or transactions for which he had used cashier's checks. In this interview, Mr. Martin told respondent's agent that all checks drawn for personal expenses on the business bank accounts were marked "Prop." Mr. Martin did not tell respondent's agent about the two boats he

had purchased when questioned about assets he had purchased. Mr. Martin did not tell the special agent about the gifts he had made to his children during the years here in issue when questioned about gifts he had made.

Mr. Martin was indicted and tried for violation of section 7201 for wilfully attempting to evade or defeat income tax for each of the years 1971 through 1975. At the conclusion of the presentation of evidence on behalf of the government, the court directed Mr. Martin's acquittal on all accounts.

Respondent in his notice of deficiency, mailed to petitioners on April 3, 1981, determined petitioners' tax liability on a net worth plus personal expenditures basis. Respondent determined petitioners' taxable income to be in the following

amounts for the years indicated:

| 1970 | 1971 | 1972 |
|---|---|---|
| $54,116.32 | $42,076.36 | $89,364.64 |

| 1973 | 1974 | 1975 |
|---|---|---|
| $40,500.23 | $71,702.66 | $117,120.70 |

Respondent also determined that petitioners were liable for the addition to tax under section 66553(b) for fraud. Respondent in that amendment to answer, alleged in the alternative that if the Court determined that the returns filed for each of the years here in issue were not false and fraudulent so as to remove the bar of the statute of limitations on the assessment of tax, the statute of limitations was open for the years 1974 and 1975 because there had been an ommision of more than 25% of gross income and the 6 year statute of

limitations provided for by section 6501(e) had not expired at the time of the issuance of the notice of deficiency.

OPINION

Petitioners have conceded the computation of their tax liability by respondent under the net worth method except for the claim that the excise taxes which they paid after the investigation by the state tax auditor should be an adjustment to the income computed under the net worth method and respondent has conceded their right to such an adjustment. Petitioners' contention in this case is that no part of the underpayment of tax was due to fraud on the part of Mr. Martin, and that since the returns for each of the years here involved were not false or fraudulent the statute of limitations bars the assessment and collection of any tax. Petitioners also contend that respon-

dent has failed to prove an understatement of gross income of more than 25 percent for the years 1974 and 1975 and, therefore, the 6-year statute of limitations under section 6501(e) is not applicable to these two years in the event the Court holds that the returns for those years were not fraudulent. In the alternative, petitioners contend that if there is any deficiency in tax for any of the years here in issue which is not barred by the statute of limitations, Mrs. Martin should be relieved from such deficiency in tax as an innocent spouse under the provisions of section 6013(e)[2].

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2 At the conclusion of the trial in this case, petitioners moved that the Court hold respondent had failed to establish fraud on the part of Mrs. Martin. Respondent conceded at that time that he had not established fraud on the part of Mrs. Martin, and based on this concession the Court granted petitioners' motion and determined that there was no fraud shown in any of the years here in issue on the part of Mrs. Martin.

As both parties recognize, the burden of showing that part of the underpayment of tax by petitioners was due to fraud on the part of Mr. Martin and that petitioners' return for each year was false or fraudulent so as to lift the bar of the statute of limitations is upon respondent. Respondent must establish the existence of such fraud by clear and convincing evidence. Marsellus v. Commissioner, 544 F.2nd 883, 885 (5th Cir. 1977), affirming a Memorandum Opinion of this Court. Ross Glove Co. v. Commissioner, 60 T.C. 569, 608 (1973).

The cases uniformly hold that the existence of a deficiency in tax standing alone is not sufficient to show fraud. Likewise, a failure by a taxpayer to report income or an understatement of income without more does not establish fraud. However, since fraud is a question of intention, it

is rare that it can be shown by direct evidence but generally must be established by inferences drawn from the conduct of the taxpayer and all other facts and circumstances of record. Gajewski v. Commissioner, 67 T.C. 181, 199-200 (1976), affirmed without published opinion 578 F.2d 1383 (8th Cir. 1978). Fraud within the meaning of section 6653(b) and section 6501(c)(1) is an intentional wrongdoing with the intent to evade a tax known or believed to be owing. Webb v. Commissioner, 394 F.2d 308 (5th Cir. 1941). Fraud is not established merely by evidence which creates a suspicion. Even a strong suspicion is not sufficient to show fraud, but fraud must be established by evidence that is clear and convincing. Thurston v. Commissioner, 28 T.C. 350(1957).

In a number of cases it has been held

that consistent and substantial understatement of large amount of taxable income over a period of years in and of itself is strong evidence of fraud. Merritt v. Commissioner, 301 F.2d 484 (5th Cir. 1962), affirming a Memorandum Opinion of this Court. Smith v. Commissioner, 32 T.C. 985, 987 (1959). In Merritt v. Commissioner, supra at 487, the Court stated that:

> The mere understatement of income, standing alone, is not enough to carry the burden cast upon the Commissioner in seeking to recover fraud penalties. But each case is to be considered in the light of its own facts. Consistent and substantial understatement of income is by itself strong evidence of fraud. This proof, coupled with the showing that the records were both incomplete and inaccurate, and that the petitioner did not supply the bookkeeper with all of the data necessary for maintaining complete and accurate records, is enough to warrant the Tax Court in finding fraud. Reaves v. Commissioner, 5th Cir. 1961, 295 F.2d 336; Cefalu v. Commissioner, supra; Bryan v. Commissioner, supra.

Against the background of the above-stated principles, we must weigh the evidence

in this case. The record here shows a substantial understatement of income for each of the years involved. The understatements are substantial as to business receipts as well as income. The records show that while petitioners were showing income in amounts ranging from approximately $7,000 to $17,000 a year, including the interest income reported by them, they were depositing amounts in their bank accounts each year ranging from $23,000 to $58,000. Although Mr. Martin claims that the understatements of income were due to his poor bookkeeping ability, his poor health and his lack of formal education past the 11th grade, the record offers no explanation of how he could consider that more money could be added each year to his savings accounts than the total income he reported. The only rational conclusion from these facts is that

Mr. Martin knew of the underreporting of his income. Knowingly underreporting income on a tax return is in itself a strong indication of fraud. However, the record further shows that when Mr. Martin's attention was called by the State sales tax auditor to his substantial underreporting of sales receipts and the auditor suggested that amended returns be filed for 1973, 1974 and 1975, Mr. Martin filed amended returns using the adjusted bank deposits as determined by the State sales tax auditor, but increasing cost of goods sold and certain other deductions in two of the years to such extent that no additional income but rather a decrease in income was reported. For the year in which income was increased, the total reported income was less than the amount added that year to petitioners' savings accounts. By the time these

amended returns were filed, Mr. Martin's attention had been called to the understatements of receipts and he should have been alerted to the fact that his income was grossly understated by merely looking at the increases in his savings accounts. Mr. Martin was certainly aware at this time that not all of his receipts were deposited in his bank accounts. However, he used as receipts the amounts computed by the State sales tax auditor from his bank deposits as his total gross receipts, thus attempting to conceal cash receipts. Mr. Martin was also aware at the time he filed the amended returns, of the boat he had purchased with cashier's checks for $26,000 in a year when he reported much less than that amount of income on both his original and amended returns. He was also aware of the gifts he had made to his children during the years

here in issue.

While it is the orignial return which must be fraudulent, Mr. Martin's actions with respect to the amended returns support an intent to defraud at the time the original returns were filed. The fact that adequate records were not kept to accurately reflect the income from Pugh's Floral Shop, standing alone, might indicate negligence rather than fraud. However, when this fact is coupled with a consistent understatement of receipts and income during a time when Mr. Martin knew that sales were increasing, it indicates fraud with intent to evade tax.

Petitioners' dealings in cash, particularly payment of personal expenses, wages, and some purchases in cash, standing alone might not be sufficient to show fraud. However, large cash payments without adequate records of such payments is an indication

of fraud.

On the basis of this record as a whole, we conclude that respondent has established by clear and convincing evidence that some part of the underpayment of tax in each of the years here in issue was due to fraud on the part of Mr. Martin with intent to evade tax, and that the return for each of the years here in issue was false and fraudulent so that the statute of limitations does not bar the assessment and collection of the deficiencies.

In arriving at our conclusion, we have not overlooked the testimony of the first revenue agent who began investigating petitioners' tax returns for the years 1973, 1974, and 1975. However, in our view that agent did not sufficiently investigate peitioners' tax liability for his

opinion with respect to petitioners' intent in underreporting their income to be of any help to the Court. This agent apparently began his investigation with the amended and not the original returns since he was of the opinion that the main reason for the understatement of income was failure to include in receipts cash used to pay wages. The entire testimony of this agent shows that he had not made sufficient investigation with respect to petitioners' tax liability to be able to have his testimony be of any value in the case.

Likewise, we have not overlooked petitioners' testimony of reliance on a tax return preparer. The record shows that the return preparer prepared the returns from figures furnished to her by Mr. Martin. Mr. Martin was unable to satisfactorily explain how be believed

the estimates he furnished to the return preparer might accurately state his receipts, income and deductions. The furnishing of such false information to the return preparer by Mr. Martin is in itself an indication of fraud.

The remaining issue is whether Mrs. Martin should be afforded relief under section 6013(e). That section provides that a spouse may be relieved of liability for tax on a joint return to the extent such liability is attributed to a substantial understatement of tax due to grossly erroneous items of the other spouse. To meet the criteria of this section, the spouse claiming the benefits of section 6013(e) must show that the omitted income was that of the other spouse, that she had no knowledge and no reason to have knowledge of the substantial understatement of the

other spouse and that she did not significantly benefit from the underreporting of income. In addition to the above set out items, section 6013(e)(4)[3] provides that the liability for tax must exceed

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3 Section 6013(e)(4)

(4) UNDERSTATEMENT MUST EXCEED SPECIFIED PERCENTAGE OF SPOUSE'S INCOME.--

(A) ADJUSTED GROSS INCOME OF $20,000 OR LESS.-- If the spouse's adjusted gross income for the preadjustment year is $20,000 or less, this subsection shall apply only if the liability described in paragraph (1) is greater than 10 percent of such adjusted gross income.

(B) ADJUSTED GROSS INCOME OF MORE THAN $20,000.-- If the spouse's adjusted gross income for the preadjustment year is more than $20,000, subparagraph (A) shall be applied by substituting "25 percent" for "10 percent".

(C) PREADJUSTMENT YEAR.--For purposes of this paragraph, the term"preadjustment year" means the most recent taxable year of the spouse ending before the date the deficiency notice is mailed.

(D) COMPUTATION OF SPOUSE'S ADJUSTED GROSS INCOME. If the spouse is married to another spouse at the close of the preadjustment year, the spouse's adjusted gross income shall include the income of the new spouse (whether or not they file a joint return).

(E) EXCEPTION FOR OMISSIONS FROM GROSS INCOME.-- This paragraph shall not apply to any liability attributable to the omission of an item from gross income.

specified percentages of the spouse's adjusted gross income in the preadjustment year. It provides that if adjusted gross income in the preadjustment year of the spouse claiming the benefits of the section is $20,000 or less, the subsection applies only if the tax liability due to grossly erroneous items is greater than 10 percent of such adjusted gross income, and if the adjusted gross income of such spouse is more than $20,000 for the preadjustment year, the section shall be applied only if the tax liability exceeds 25 percent of such adjusted gross income. The pre-adjustment year is defined to mean the most recent taxable year of the spouse ending before the date the deficiency notice was mailed. The record here shows that the notice of deficiency was mailed on April 3, 1981. This record contains no infor-

mation as to Mrs. Martin's income for the preadjustment year which is the year 1980. For this reason alone, Mrs. Martin has failed to meet the burden of showing that section 6013(e) is applicable in her case. However, there are other reasons why the section is not applicable to Mrs. Martin. The record here shows that the Pugh's Floral Shop was a partnership owned equally by petitioner and Mrs. Martin. Therefore, one-half of the proper income of the business was Mrs. Martin's partnership income. Although because of respondent's concession, we held at the conclusion of the trial that respondent had failed to show fraud on the part of Mrs. Martin, this fact does not mean that the proper income of the floral shop was not one-half Mrs. Martin's income. For this reason, Mrs. Martin has

failed even to show that the omitted income was that of her husband only. Secondly, Mrs. Martin was aware of the gifts being made to her children and also of the deposits in the various savings accounts. For this reason she certainly should have known that the income reported on her joint return with her husband was understated. Finally, Mrs. Martin profited from the omitted income since she owned at least some,if not all, of the various savings accounts and certificates of deposit jointly with her husband. Based on this record, we conclude that although Mrs. Martin is not liable for the addition to tax for fraud under section 6653(b) because of respondent's failure to show fraud on her part, she is not entitled to be relieved from the deficiencies under section

6013(e).

At the trial, respondent agreed that adjustments should be made in the net worth statements for the additional sales taxes determined against petitioners for the years 1973, 1974, and 1975. Because of this concession,

Decision will be entered under Rule 155.